Mitigating the Concerns of Angel Tax

What is the issue?

\n\n

\n
- Indian business community is disappointed due to the Angel tax which is regressive in nature.
\n
- Union government need to design a tax such that it will not affect the cash flow for a start-up.
\n

\n\n

What is an Angel Tax?

\n\n

\n
- In India an angel tax was introduced in Union Budget of 2012 under the Finance Act 2012.
\n
- It is a 30.9 % tax levied on investments made by external investors in start-ups or companies.
\n
- Under this tax the entire investment is not taxed only the amount that is considered above "fair value" valuations of the start-up, classified as 'income from other sources' in the Income Tax Act of India.
\n
- The tax will be charged both on cash investments as well as on share premium paid to acquire new shares in a company that the tax authorities regard as excessive.
\n

\n\n

What are the reasons behind the implementation of Angel tax?

\n\n

\n

- Angel Tax was introduced in 2012, it was when the general public was convinced that the entire administrative machinery of the Government was steeped in corruption.
\n
- At that time every facet of public policy had come to be clothed with the miasma of personal profit rather than genuine public interest.
\n
- This was after all the era of the Commonwealth Games scam, the 2G scam, the coal-block allotment scam and so on.
\n
- The income tax department considers that the present value of all future cash flows in the business is a lot less and therefore seeks to impose a tax on such perceived excess premium.
\n
- That a tax on invested capital is against all accepted notions of what constitutes a tax on income, and is beyond dispute.
\n

\n\n

What are the concerns with Angel taxes?

\n\n

\n

- The problem arises because start-ups are often valued subjectively on the basis of discounted cash flows, without taking into account intangibles like goodwill.
\n
- This can cause differing interpretations of “fair value” and leave start-ups vulnerable to unduly high taxes because the taxman feels the investment is too high over their valuation.
\n
- Angel taxation is a major thorn in the side for many ventures and has forced many angel investors to shy away from offering financial support to start-up dreams.
\n

\n\n

What measures needs to be taken?

\n\n

\n

- Government need to design a system around the provisions of an ‘angel tax’ regime with none of the cash flow implication that such a tax entails:\n\n
\n
  1. That excess share premium, such as it is, will be recognised as income.
\n
  2. The resultant figure of tax will however not trigger any cash pay-out but instead will be recognised as a deferred tax liability in the books of the enterprise.
\n
  3. The outstanding tax obligation may be permitted to be liquidated against actual fixed capital expenditure or incremental working capital needs through suitable accounting entries.
\n
\n
\n
- Thus the venture capital industry hopes for an emphasis on adverse cash flow consequences of the proposal be mitigated in some way.
\n

\n\n

\n\n

Source: Business Line

\n